Santa Clara University School of Law

Santa Clara Law Review

Volume 34 | Number 1 Article 4

1-1-1993

The Lawyer's Proper Role in the Examination of Financial Institutions: Defining the Duty to Disclose After Kaye, Scholer

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COMMENTS

THE LAWYER'S PROPER ROLE IN THE EXAMINATION OF FINANCIAL INSTITUTIONS: DEFINING THE DUTY TO DISCLOSE AFTER KAYE, SCHOLER

I. INTRODUCTION

The 1992 suit against Kaye, Scholer, Fierman, Hays & Handler (Kaye, Scholer) by the Office of Thrift Supervision (OTS)[1] has left the public wondering about an attorney's proper role and legal duty to disclose in a savings and loan examination.[2] The suit originated when Kaye, Scholer represented Charles Keating's Lincoln Savings and Loan (Lincoln) in an examination conducted by the Federal Home Loan Bank Board (FHLBB).[3] In its complaint, the OTS generally charged two things against Kaye, Scholer. First, the OTS alleged that the firm's lawyers knowingly and repeatedly misrepresented facts to the FHLBB concerning Lincoln's finan-

1. "An office in the Treasury Department charged with providing for the examination, safe and sound operation, and regulation of savings associations." BLACK'S LAW DICTIONARY 1083 (6th ed. 1990).

2. The Kaye, Scholer matter raises several issues about an attorney's responsibility in an examination, including the lawyer's duty of inquiry, the scope and content of the lawyer's advice, climbing the corporate ladder within the institutional client, and conflicts of interest arising from dual representation of a depository institution and its holding company. *See* AMERICAN BAR ASSOCIATION, *Laborers in Different Vineyards? The Banking Regulators and the Legal Profession* 181- 212 (January 1993) (discussion draft to the President and Board of Governors of the American Bar Association on file with author). This comment discusses only one issue raised by the Kaye, Scholer matter: the lawyer's duty to disclose.

3. "The federal agency formerly charged with regulating federal savings and loan associations and the Federal Home Loan Bank system. Abolished in 1989, its functions are now performed by the Office of Thrift Supervision and the Federal Housing Financing Board." BLACK'S LAW DICTIONARY 611 (6th ed. 1990).

cial condition.[4] Second, the OTS charged that Kaye, Scholer failed to disclose facts material to the examination.[5]

To justify its complaint, the OTS argued that savings and loan examinations, by regulation, require disclosure of all material information.[6] Therefore, presenting facts to the FHLBB during an examination is similar to filing a prospectus with the Securities and Exchange Commission (SEC).[7] Accordingly, the OTS argued, the attorney who presents facts to the OTS should have a duty, like that of an attorney practicing before the SEC, to disclose all facts—good and bad—that could possibly be material to the OTS.[8]

In its defense, Kaye, Scholer argued that the examination is more like an adversarial proceeding.[9] Thus, the attorney who represents a financial institution, like an attorney at trial, should have no duty to disclose facts adverse to the client and should be able to present evidence in a light most favorable to the client.[10] Charles Wolfram, an observer of the suit against Kaye, Scholer, notes: "At the time [Kaye, Scholer] acted, it had no clear guidance . . . from the ABA, New York, or D.C. lawyer codes, or from 12 CFR (the OTS's own regulation[s]), or from Treatise writers."[11] Of course, some guidance could have been established through a judicial ruling of the suit against Kaye, Scholer. But because the firm and the OTS settled out of court,[12] these issues were never litigated. Consequently, it is unclear whether a savings and loan examination is more SEC-like than adversarial, and, therefore, the proper standard for an attorney's duty to disclose during an examination remains undefined. As Wolfram notes: "[T]he line between situations of advocacy and situations permitting only lesser zeal is murky, largely unex-

4. Notice for the Office of Thrift Supervision 10, 19, 61, *In re* Fishbein (1992) (OTS AP-92-19) [hereinafter Notice of Charges].

5. *Id.* at 14, 19, 28, 34, 48, 61, 68.

6. *See infra* text accompanying notes 79-83.

7. *See infra* text accompanying notes 79-83.

8. *See* discussion *infra* part II.B.3.

9. *See infra* text accompanying notes 90-103.

10. *See* discussion *infra* part II.B.3.

11. Charles W. Wolfram, *Mapping the Minefield: The Applicable Ethics Rules and Conflicting Duties, in* THE ATTORNEY- CLIENT RELATIONSHIP AFTER KAYE, SCHOLER 53, 60 (PLI Corp. Law & Practice Course Handbook Series No. 779 (1992)).

12. *See infra* text accompanying note 77.

plored, and problematical [even] under OTS' own regulations."[13]

Defining an attorney's role in an examination is important to the public, to the legal profession, and to regulated financial institutions. As to the public, the recent savings and loan bailout could cost taxpayers over $500 billion.[14] Consequently, as public fiduciaries, the legal profession should strive to define an attorney's proper function in the examination proceeding to enhance the overall regulatory process and to limit the fiscal impact on the public.[15] To the legal profession, the ominous overtones of the suit against Kaye, Scholer and other similar cases may signal that attorneys practicing before regulatory agencies will now be subject to higher standards.[16] Indeed, some have feared that the Kaye, Scholer affair now imposes a duty on lawyers to "blow the whistle" on their clients, effectively eliminating the attorney-client privilege in the financial examination context.[17] Higher standards also result in greater liability for attorneys.[18] Suits against attorneys have already increased,[19] which may escalate legal malpractice premiums by as much as fifty percent in the next two years.[20] In addition, despite the increase in premiums, the extension of coverage is shrinking as insurance companies find more and more exceptions to coverage.[21] For regulated financial institutions, the result is an increase in the already high cost for legal repre-

13. Wolfram, *supra* 11, at 60.

14. Lucia J. Mandarino, *Too Many Consonants and Not Enough Consonance: The Development of the S&L Regulatory Framework*, 59 FORDHAM L. REVIEW 263, 263 (1991).

15. *See* Stanley Sporkin, *The New World of Lawyering*, P-H Law & Business, Apr., 1992, *available in* WESTLAW, TP-ALL, 6 No. 4 PH-INSTIT 2.

16. Eugene M. Katz, *A Summary of Issues Concerning the Liability of Attorneys Representing Financial Institutions, in* LITIGATING FOR AND AGAINST THE FDIC AND THE RTC 1992, at 591, 596 (PLI Commercial Law and Practice Course Handbook Series No. 625 (1992)).

17. *See* Stephen Labaton, *Debate Revived Over Lawyers Blowing Whistle*, CHI. DAILY L. BULL., Mar. 6, 1992, at 5.

18. Katz, *supra* note 16, at 596.

19. *See* Karen Donovan, *Lawyers at Risk, S&L Officials Tell Angry ABA Groups*, NAT'L L.J., Aug. 24, 1992, at 19.

20. *See* Lee Berton, *Partnership Structure Called in Question as Liability Risk Rises*, CHI. DAILY L. BULL., June 19, 1992, at 5. *See also* Jennifer E. King, *Recent Malpractice Suits Driving up the Cost of Lawyers Liability Insurance*, MERRILL'S ILL. LEGAL TIMES, Nov. 1992, at 1; Edward A. Adams, *N.Y. Firms Are Hit First*, NAT'L L. J., Oct. 26, 1992, at 3.

21. King, *supra* note 20, at 1.

sentation as banking counsel pass on the additional costs to clients. Alternatively, banking firms may choose not to represent savings and loan institutions, thereby decreasing the availability of legal representation for financial institutions.[22]

Given the importance of defining an attorney's role in savings and loan examinations and the lack of guidance for applicable disclosure standards, the questions presented by this comment are: (1) To what extent does the nature of the examination proceeding determine attorney responsibility? (2) What type of proceeding characterizes an OTS examination — an SEC-like proceeding or an adversarial one? (3) Given the nature of an OTS examination, what role should an attorney play in the examination, and what standards of disclosure[23] should apply to the attorney vis-à-vis the regulatory agency? Although many factors can influence an attorney's duties,[24] Charles Wolfram noted that the nature of the proceeding is the "most important" factor.[25]

To answer these questions, this comment explores a typical savings and loan examination and the financial institu-

22. Lawrence J. Fox, *Your Right to Counsel Threatened,* NAT'L L. J., Nov. 23, 1992, at 13. *But see* Larry Smith, *Still Reeling in the Wake of S&L Suits, Law Firms Grope for Solutions,* August 3, 1992, *available in* WESTLAW, LAWPRAC, 11 No. 15 PH-OFC 1 (quoting lawyers who see no shortage of adequate counsel for savings and loan clients in today's market).

23. When dealing with corporate clients, as in the Kaye, Scholer situation, an attorney's duty to disclose can be "outside the client" (when an attorney discloses information to a regulatory agency, such as the OTS) or "inside the client" (when an attorney discloses information to the Chief Executive Officer of the corporation the attorney represents). *See generally* Wolfram, *supra* note 11. Although the Kaye, Scholer and OTS settlement raises both issues, this comment will be limited to disclosure "outside the client."

24. *See, e.g.,* Wolfram, *supra* note 11, at 60-61 (asserting that the lawyer's duties are influenced by the lawyer's self-described area of specialization; the explicit or implicit terms of the client-lawyer retention; the degree of aggressiveness, level of noise, or other lawyerly manifestations of the lawyer in the course of the work; the desirability of providing certain role-related functions to the client; and whether the lawyer's responsibility is in-office or directed more at third persons); Katz, *supra* note 16, at 609-10 (asserting that higher standards of duty may result when the attorney also serves on the board of directors of a client institution or when the attorney's scope of engagement is broader, or when the attorney's relationship with the client institution is more intimate than that of attorneys who provide legal services only on selected matters); Sporkin, *supra* note 15, at 2 (asserting that a lawyer's duty to disclose a client's misdeeds varies greatly depending upon the client's field of specialty and the lawyer's area of practice).

25. Wolfram, *supra* note 11, at 60-61.

tion's duty to disclose.[26] Next, Lincoln's examination and the litigation between Kaye, Scholer and the OTS are reviewed to shed light on issues relevant to the attorney's function and duty to disclose during an examination.[27] The Lincoln scenario is then expanded by hypothetical examples in order to probe deeper into subtle problems of the attorney's role and the attorney's duty to disclose.[28] A proceeding before the SEC and an adversarial proceeding are then discussed as a basis for comparison to a savings and loan examination and to Lincoln's examination in particular.[29] Based on these comparisons,[30] several proposals are made regarding the role of the attorney in the OTS examination context and the disclosure standards that should apply.[31]

In short, it is suggested that the *nature* of a proceeding determines the attorney's role and duty to disclose.[32] In an OTS examination, the nature of the proceeding is substantially different from that of an adversarial trial, thus making traditional advocacy inappropriate.[33] Rather than that of an advocate advancing arguments most favorable to the client institution, the proper role of counsel is that of an adviser and watchdog.[34] As such, privileges against disclosure, commonly available to the litigator, should be unavailable to counsel in an examination.[35] This does not mean that an attorney who makes no representations to the regulatory agency should be subjected to the same duty to disclose as the institution itself.[36] On the other hand, if an attorney chooses to make representations to the regulatory agency, the nature of the examination is not unlike that of filing a prospectus with the SEC, in which both the issuer and issuer's counsel should

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26. *See* discussion *infra* part II.A.

27. *See* discussion *infra* parts II.B.1, II.B.3.

28. *See* discussion *infra* part II.B.2. The hypotheticals were derived from the Lincoln affair itself and from hypotheticals found in American Bar Association, *Laborers in Different Vineyards? The Banking Regulations and the Legal Profession* 156-57, 159-60 (January 1993) (discussion draft to the President and Board of Governors of the American Bar Association on file with author).

29. *See* discussion *infra* parts II.C, II.D.

30. *See* discussion *infra* part III.

31. *See* discussion *infra* part IV.

32. *See* discussion *infra* part III.C.

33. *See* discussion *infra* part III.B and text accompanying notes 266-75.

34. *See* discussion *infra* part III.B and text accompanying notes 266-75.

35. *See* discussion *infra* part IV.

36. *See* discussion *infra* part IV.

have the same duty to disclose.[37] In this situation, the attorney in an examination would have a duty to reveal all information that could possibly be material to the OTS in its examination of the financial institution.[38]

II. BACKGROUND

A. *Examinations in General*

1. *Nature of the Proceeding*

The purpose of the OTS and similar regulatory agencies[39] is to promote the safety and soundness of these financial institutions.[40] One of the powers granted by Congress to achieve this goal is a periodic, on-site examination of banks and savings and loan institutions.[41] During an OTS examination, every phase of the institution's operations is subject to scrutiny.[42] Typically, an examiner evaluates the institution's management, asset quality, capital adequacy, nature of its liabilities, compliance with laws and regulations, and various controls, procedures, accounting practices, and insurance.[43] The examiners inspect policy and procedure manuals, interview personnel, and appraise previous internal and external audits.[44]

The in-depth examination process serves several goals. First, the periodic, on-premises examination affords examiners the best opportunity to verify whether a financial institution has adhered to applicable laws and regulations.[45] Second, regular evaluations of a bank's capital adequacy, asset quality, management, liquidity position, and earnings capacity allow regulatory agencies to identify unhealthy or deterio-

37. *See* discussion *infra* part IV.

38. *See* discussion *infra* part IV.

39. *See infra* note 41.

40. *See* BLACK'S LAW DICTIONARY 1083 (6th ed. 1990).

41. For information regarding the various regulatory agencies and the overall scheme of banking regulation, see generally MICHAEL P. MALLOY, THE REGULATION OF BANKING: CASES AND MATERIALS ON DEPOSITORY INSTITUTIONS AND THEIR REGULATORS (1992).

42. Michael Doman, *The Nature and Purpose of Supervisory Examinations*, *in* THE BANKER'S HANDBOOK 1090, 1093 (William H. Baughn & Charles E. Walker. eds., rev. ed. 1978).

43. JOSEPH F. SINKEY, JR., PROBLEM AND FAILED INSTITUTIONS IN THE COMMERCIAL BANKING INDUSTRY 28 (1979).

44. Doman, *supra* note 42, at 1095.

45. JOHNATHAN R. MACEY & GEOFFREY P. MILLER, BANKING LAW AND REGULATION 579 (1992).

rating conditions, thus maintaining public confidence in the integrity of the banking system and in individual banks.[46] In other words, "the examination supplies the supervisor with an understanding of the nature, relative seriousness and ultimate cause of a bank's problems, and thus provides a factual foundation to soundly base corrective measures, recommendations and instructions."[47] Further, since the examination process can help to prevent uncorrected problems from deteriorating to the point where costly financial assistance by the FDIC becomes unavoidable, the examination process also helps to protect the financial integrity of the deposit insurance fund.[48]

2. *The Bank's Duty to Disclose*

To complement the broad investigatory powers of such regulatory agencies, statutory law governing a financial institution's duty to disclose imposes high standards of disclosure.[49] For instance, a financial institution examined by the OTS is subject to 12 C.F.R. § 563.180(b), which provides:

> *False or misleading statements or omissions.* No savings association or director, officer, agent, employee, affiliated person, or other person participating in the conduct of the affairs of such institution nor any person filing or seeking approval of any application shall knowingly:
> (1) make any written or oral statement to the Office [of Thrift Supervision] or to an agent, representative or employee of the Office that is false or misleading with respect to any material fact or omits to state a material fact concerning any matter within the jurisdiction of the Office; or
> (2) make any such statement or omission to a person or organization auditing an insured institution or otherwise preparing or reviewing its financial statements concerning the accounts, assets, management condition, ownership, safety, or soundness, or other affairs of the association.[50]

In short, a financial institution undergoing an examination by the OTS has a clear duty to disclose all facts that could be material to the OTS in its evaluation.

46. *Id.*
47. *Id.*
48. *Id.*
49. *See, e.g.,* 12 C.F.R. § 563.180(b) (1991).
50. *Id.*

As presented by the Kaye, Scholer affair, it is unclear whether the same duty to disclose extends to the *attorney* representing the financial institution during an examination.[51] To date, there is no case law that has interpreted this problem. According to the FHLBB's own regulations, applicable here, its rules "are not intended to require attorneys to report to the [FHLBB] violations of laws and regulations by the clients or infringe otherwise on the attorney-client privilege."[52] However, as previously noted, in its recent suit against Kaye, Scholer, the OTS argued that the firm had a duty to disclose all material facts relevant to the regulators.[53] Thus, many commentators have expressed concern that the OTS' position effectively eliminates the attorney-client privilege in the financial examination context.[54] Given these conflicting signals from the OTS and the absence of guidance from other traditional sources,[55] this comment seeks to determine whether an attorney should be subject to such material standards of disclosure by comparing the *nature* of an examination to the two proceedings to which it has been likened—a proceeding before the SEC and an adversarial proceeding.[56] This comment emphasizes that the nature of a proceeding determines an attorney's rights and duties, including the attorney's duty to disclose.[57]

Before turning to these two proceedings, however, it is essential to look at Lincoln's examination[58] and some hypothetical examples[59] derived from the Lincoln scenario in order to understand the subtle points of the problem. It is also important to review the OTS' and Kaye, Scholer's positions to understand how each organization perceived the examination.[60] At that point, it is appropriate to inquire into the exact nature of these proceedings,[61] to make an informed judgement regarding the nature of the OTS examination, and to

51. *See supra* text accompanying notes 1-13.
52. 12 C.F.R. § 12 (1991).
53. *See supra* text accompanying note 8.
54. *See, e.g., supra* text accompanying note 17.
55. *See supra* text accompanying note 11.
56. *See supra* text accompanying notes 8-10.
57. *See* discussion *infra* part III.C.
58. *See* discussion *infra* part II.B.1.
59. *See* discussion *infra* part II.B.2.
60. *See* discussion *infra* part II.B.3.
61. *See* discussion *infra* parts II.C, II.D.

examine how its similarity to other proceedings dictates the lawyer's proper role and duty to disclose.

B. *What Happened When Kaye, Scholer Represented Lincoln?*

1. *The Examination of Lincoln*

The Federal Home Loan Bank Board, part of which later became the OTS,[62] began an examination of Lincoln Savings and Loan in March of 1986.[63] During the examination, Lincoln retained Kaye, Scholer, who instructed bank examiners to channel all their requests through its New York office instead of dealing directly with Lincoln.[64] Kaye, Scholer provided all responses to OTS' requests for information.[65] In this respect, the Lincoln examination was unique in that Kaye, Scholer interposed itself between Lincoln and the OTS.[66]

Of particular relevance to this comment are factual representations made by Kaye, Scholer to the regulatory agency. During the examination, Kaye, Scholer made factual statements and representations to the OTS regarding Lincoln's financial posture.[67] These included the status of certain direct investments, Lincoln's net worth, its loan and securities underwriting procedures, the proper classification of certain loans or joint ventures, and transactions with affiliates and related matters.[68] However, according to the *Wall Street Journal*, "[i]n virtually every instance complained of by the OTS, there were apparently facts known to Kaye, Scholer, in many instances reflected in Kaye, Scholer's internal memoranda, that severely called into question the accuracy or completeness of the statements Kaye, Scholer was making to the

62. The OTS succeeded the FHLBB on August 9, 1989, pursuant to the provisions of the Financial Institutions Reform, Recovery and Enforcement Act of 1989. 12 U.S.C. § 1437 (Supp. 1992).

63. Kaye, Scholer, Fierman, Hays & Handler, Summary of the Expert Opinion of Geoffrey C. Hazard, Jr. 2 (February 25, 1992) (unpublished manuscript, on file with author) [hereinafter Hazard Opinion].

64. Amy Stevens and Paulette Thomas, *How a Big Law Firm Was Brought to Knees by Zealous Regulators*, WALL ST. J., Mar. 13, 1992, at A1.

65. John L. Douglas and John K. Train, *Kaye, Scholer Case: Lessons for Banking Lawyers and Clients*, May 4, 1992, *available in* WESTLAW, TP-ALL, 11 No. 9 PH-BNKPR.

66. *See infra* text accompanying note 79.

67. Douglas, *supra* note 65.

68. *Id.*

regulators."[69] For example, during the examination, Kaye, Scholer met with Lincoln's outside auditing firm, Arthur Andersen & Co., which at the time made several negative comments regarding Lincoln's financial posture, including a statement that "Lincoln looks like most of the other S&L's that have failed" and that "Andersen views Lincoln as a high-risk client."[70] Two months later, Andersen abruptly resigned its Lincoln account and issued a formal statement that the pullout did not result from concerns about the thrift's financial health.[71] Kaye, Scholer sent the OTS a copy of this final statement, which was prepared by Lincoln but did not include Andersen's earlier remarks.[72] At the time, Kaye, Scholer reasoned that Andersen's previous remarks did not contradict the subsequent official statement and that the OTS never formally asked for any information that would cast doubt on the official statement.[73]

On March 2, 1992, the OTS filed a Notice of Charges against Kaye, Scholer for $275 million.[74] In addition to seeking restitution from Kaye, Scholer, the OTS sought to bar four Kaye, Scholer partners from practice involving federally insured banks and thrifts.[75] Moreover, the OTS issued a temporary cease-and-desist order, effectively freezing the firm's assets.[76] In less than a week, Kaye, Scholer, although

69. *Id.*

70. Stevens & Thomas, *supra* note 64, at A1, A6.

71. *Id.*

72. *Id.*

73. *Id.*

74. *Id.* The OTS charged that Kaye, Scholer: 1) ignored several material facts when it advised Lincoln that its direct investments were properly grandfathered; 2) engaged in dilatory, obstructionist conduct; 3) failed to fulfill its fiduciary duties to Lincoln; 4) helped to obtain an illegal loan on favorable terms for one of the Kaye, Scholer partners; 5) knowingly failed to disclose that Lincoln removed adverse documents and created favorable documents in preparation for the 1986 Examination; 6) knowingly failed to disclose facts indicating that Lincoln participated in limited partnership investments in order to finance personal tax shelters for executive officers of Lincoln's parent company; and 7) engaged in improper and unethical conduct by representing both Lincoln and its parent company, thus creating a conflict of interest. *See generally* Notice of Charges, *supra* note 4; Thomas W. MacIsaac & Bettina Lo Alexander, *Protecting Yourself and Your Firm in the Representation of Insured Depository Institutions: Lessons to be Learned from the Kaye, Scholer Case, in* INSIDER TRADING, FRAUD, AND THE FIDUCIARY DUTY UNDER THE FEDERAL SECURITIES LAWS (ALI-ABA Course of Study (1993)).

75. Steven & Thomas, *supra* note 64, at A1, A6.

76. *Id.* Substantial debate has been generated over the OTS' use of the freeze order. *See, e.g.*, Edward A. Adams, *Panel Condemns Kaye, Scholer Asset*

admitting no wrongdoing, settled with the OTS for $41 million.[77]

2. *Extending the Lincoln Scenario*

The example of Kaye, Scholer's failure to disclose Arthur Andersen's comments is merely one point along a continuum of complex problems facing banking counsel that may or may not give rise to attorney liability. The following hypothetical examples are designed to reveal some of the subtle problems facing attorneys who represent financial institutions. For simplicity, all hypothetical examples are permutations of the Lincoln example. In each scenario, the reader should ask: Is the attorney liable for failing to disclose?

a. *Attorney Representations to the Regulatory Agency*

(i) *Attorney blatantly lies*

During an examination, OTS asks S&L why its previous accounting firm resigned. Lawyer, recently retained by S&L, knows that Accounting Firm said that S&L looks like most of the other savings and loans that have failed and that S&L is a high-risk client. Lawyer states to OTS: "Accounting firm resigned because of workload."

(ii) *Attorney tells the truth, but knowingly omits a material fact*

As in the previous example, Lawyer knows that Accounting Firm said that S&L looks like most of the other savings and loans that have failed and that S&L is a high-risk client. However, Lawyer subsequently receives a letter from Accounting Firm. Letter states that Accounting Firm resigned because of workload. Lawyer states to OTS: "Accounting Firm resigned because of workload."

Freeze, in THE ATTORNEY-CLIENT RELATIONSHIP AFTER KAYE, SCHOLER 505 (PLI Corp. Law & Practice Course Handbook Series No. 779 (1992)).

77. Stevens & Thomas, *supra* note 64, at A1.

(iii) *Attorney tells the truth, unknowingly omitting a material fact, yet "red flags"*[78] *beg further inquiry*

As in the previous example, Lawyer receives a letter from Accounting Firm, stating that Accounting Firm resigned because of workload. Lawyer has been retained halfway through the examination. Lawyer does *not* know that Accounting Firm previously said that S&L looks like most of the other savings and loans that have failed and that S&L is a high-risk client. However, the prior law firm inexplicably resigned. One of the internal memoranda from the prior firm reads: "I think Accounting Firm may fear excessive liability." Nevertheless, Lawyer states to OTS: "Accounting Firm resigned because of workload."

(iv) *Attorney tells the truth, unknowingly omitting a material fact, yet no "red flags" appear*

When Lawyer is retained, S&L conceals memo written by the previous law firm that states, "I think Accounting Firm may fear excessive liability." Lawyer receives a letter from Accounting Firm, stating that Accounting Firm resigned because of workload. Lawyer states to OTS: "Accounting Firm resigned because of workload."

b. *Client Representations to the Regulatory Agency*

As in the previous subset, OTS asks why Accounting Firm resigned. Both S&L and S&L's Lawyer know that Accounting Firm said that S&L looks like most of the other savings and loans that have failed and that S&L is a high-risk client. S&L, with the knowledge (but not the approval) of Lawyer, states to OTS: "Accounting Firm resigned because of workload."

c. *Material Discovered Outside the Scope of Employment*

Suppose that the employment contract between Lawyer and S&L limits Lawyer's function during the examination to reviewing S&L's compliance with all phases of the examina-

78. Evidence that a reasonable person would investigate under the circumstances.

tion process *except* S&L's relationship with its prior accounting firm. Lawyer has been assured by S&L that this particular aspect of the examination will be handled directly and exclusively by S&L. During the examination, Lawyer learns that S&L's prior accounting firm said that S&L looks like most of the other savings and loans that have failed and that S&L is a high-risk client. What is Lawyer's duty? Can Lawyer simply continue on in the scope of his or her employment, or must he or she confront S&L with this information? If the attorney must confront S&L, and if S&L refuses to disclose to the OTS this information, must Lawyer do something more? If so, what must Lawyer do? Resign? Inform the regulators? Should it make a difference if Lawyer has made representations to the OTS during the course of the examination?

Inititially, to answer the questions raised by these hypothetical examples, it is important to examine the viewpoints of the OTS and Kaye, Scholer in the original Lincoln scenario.

3. *The Viewpoints of the OTS and Kaye, Scholer*

The OTS viewed Kaye, Scholer's mandate that all requests to Lincoln be channeled through Kaye, Scholer as an effort by the firm to interpose itself between the OTS and Lincoln.[79] The OTS reasoned that Kaye, Scholer made itself the "sole agent" for the thrift, and thus assumed Lincoln's responsibility for complying with full disclosure requirements.[80] Consequently, in its complaint, the OTS alleged that Kaye, Scholer's factual presentations to the FHLBB, which omitted information,[81] violated 12 C.F.R. § 563.18(b).[82] The OTS' regulation, much like the SEC's Rule 10b-5, prohibits omissions of any material fact concerning matters within the OTS' jurisdiction.[83]

To justify its conduct during the examination, Kaye, Scholer presented the Summary of the Expert Opinion of Professor Geoffrey C. Hazard.[84] Before discussing the Opinion's content, however, it is important to mention the Opinion's or-

79. Stevens & Thomas, *supra* note 64, at A1.

80. *Id.*

81. *See supra* text accompanying note 4.

82. Later recodified, without emendation, as 12 C.F.R. § 563.180(b). 54 Fed.Reg. 49, 552 (1993). For the full text of 12 C.F.R. § 563.180(b), see *supra* text accompanying note 50.

83. *See supra* text accompanying note 50.

84. *See infra* text accompanying notes 92-102.

igins. Professor Hazard did not write the opinion.[85] Rather, the Opinion was prepared by Kaye, Scholer after "extensive" discussions between the firm and Professor Hazard, who signed the document as an accurate summary of his opinion.[86] Moreover, this document was prepared before the OTS filed its notice of charges.[87] Hazard admits he did not read the draft notice of charges and that his comments were paraphrased by a Kaye, Scholer lawyer.[88] The accuracy of this paraphrasing is questionable. When the OTS showed Kaye, Scholer its draft notice of charges in December, the firm was not allowed to copy the notice and was only permitted to take nonverbatim notes.[89]

Based upon the history of the Hazard Opinion, one can make a better determination of the persuasive authority the Opinion carries. In short, Kaye, Scholer used the Hazard Opinion to argue that the examination is more analogous to an adversarial proceeding than to an SEC-like proceeding.[90] First, the firm noted that the scope of its representation of Lincoln defined Kaye, Scholer's role in the examination as a litigator.[91] Kaye, Scholer asserted that Lincoln sought only "litigation counsel," interviewed only Kaye, Scholer "litigators," and "retained a litigation partner" at Kaye, Scholer "to defend it" in connection with the examination.[92] Second, the firm asserted that the Lincoln examination was adversarial in nature.[93] The Hazard Opinion describes the Bank Board's Report of Examination as a legal complaint and characterizes Kaye, Scholer's responsive document as an answer to the complaint.[94]

At the end of the Opinion, Professor Hazard concluded: (1) Kaye, Scholer acted solely in the "capacity of litigation counsel"[95] and was "fair and reasonable" in understanding

85. Susan Beck & Michael Orey, *Hazard Opinion: Read With Caution,* AM. LAW., May 1992, at 75.

86. *Id.*

87. *Id.*

88. *Id.*

89. *Id.*

90. *See infra* text accompanying notes 91-102.

91. *See infra* text accompanying notes 92, 95-96, 102.

92. Hazard Opinion, *supra* note 63.

93. *See infra* text accompanying notes 94-102.

94. Wolfram, *supra* note 11, at 57.

95. Hazard Opinion, *supra* note 63, at 14.

that it so acted;[96] (2) the examiners' criticisms "reasonably could have been and were perceived by Lincoln and Kaye, Scholer as a prelude to litigation;"[97] (3) Kaye, Scholer was "governed by the standards applicable to an advocate in a matter that has become adversarial and which involves a reasonable anticipation of possible litigation;"[98] (4) "Kaye, Scholer had a duty to present Lincoln's case in its best light subject to the [Model Rule 3.1] restriction against frivolous claims and contentions;"[99] (5) "Kaye, Scholer was obligated . . . to represent its client 'zealously' and 'to seek the lawful objectives of the client through reasonably available means permitted by law,' without causing '[p]rejudice or damage [to] the client during the course of the professional relationship . . . .;'"[100] (6) Kaye, Scholer was not required to disclose weaknesses in Lincoln's position or adverse characterizations of Lincoln's conduct, as reflected in ABA Formal Opinion 352 (1985) (tax representations);[101] and (7) Kaye, Scholer was not required by materiality standards to disclose confidential information gained from Lincoln—indeed, such disclosure would have "violated the standards of ethical conduct and professional responsibility generally recognized as applicable to Kaye, Scholer in its role as litigation counsel."[102]

Based on the two differing views regarding an attorney's duty to disclose, it is appropriate to define the proceeding that formed the basis for each view. Comparisons may then be made to a typical examination to appropriately characterize the nature of an examination proceeding. Given that characterization, the attorney's role and duty to disclose during an examination may be determined.

C. *Filing a Prospectus with the SEC*

1. *Nature of the Proceeding*

Before a company is allowed to issue securities to the general public, it must file a registration statement with the

96. *Id.* at 16.
97. *Id.* at 15.
98. *Id.* at 16.
99. *Id.*
100. *Id.* (quoting MODEL CODE OF PROFESSIONAL RESPONSIBILITY, DR 7-101 (1981)).
101. *Id.* at 17-18.
102. *Id.* at 18-19.

SEC in accordance with the Securities Act of 1933.[103] Such filing requirements provide investors with material financial information concerning securities offered for sale on an open market, such as the New York Stock Exchange.[104] These requirements also prohibit the fraudulent sales of securities.[105] An attorney who represents the company issuing the securities plays a "quarterback" position in the registration process.[106] The lawyer assists the issuer in deciding what information should be included in the registration statement, how the information should be included, and to what extent its omission would raise questions under the 1933 Securities Act.[107] This responsibility requires an attorney to exercise "due diligence"[108] when investigating and verifying all disclosures for accuracy and completeness.[109] Toward this end, counsel typically solicits information and exercises his or her best judgment in evaluating the information for accuracy and consistency.[110] In short, an attorney "often serves as the principal draftsman of the registration statement."[111] Consequently, "it is often a securities lawyer who decides whether a particular securities transaction can proceed or, because of legal problems, must be cancelled."[112] Indeed, "unless a lawyer attests to the legality of a transaction by the delivery of an opinion, the parties to the transaction will not agree to proceed."[113] As one commentator has noted, "[i]t is inconceivable that corporate executives would enter into a public offer-

103. 15 U.S.C.A. § 78l (1988).

104. RICHARD W. JENNINGS ET AL., SECURITIES REGULATION CASES AND MATERIALS 103 (7th ed. 1992).

105. *Id.*

106. *Id.* at 171.

107. Association of the Bar of the City of New York, *Report by Special Committee on Lawyers' Role in Securities Transactions*, 32 BUS. LAW. 1879, 1891 (1977).

108. "Such a measure of prudence, activity, or assiduity, as is properly to be expected from, and ordinarily exercised by, a reasonable and prudent man under the particular circumstances; not measured by any absolute standard, but depending on the relative facts of the special case." BLACK'S LAW DICTIONARY 457 (6th ed. 1990).

109. JENNINGS ET AL., *supra* note 104, at 174.

110. *Id.* at 173.

111. *Id.*

112. LARRY D. SODERQUIST, SECURITIES REGULATION 572 (2d ed. 1988).

113. *Id.*

ing, merger, or other major corporate transaction without the assistance of legal counsel."[114]

The assistance of legal counsel is not only indispensable to the regulated company, but is equally important to the regulators. Because the SEC's own enforcement resources are "wholly insufficient" to police a significant portion of securities transactions, the SEC and others have argued that "a lawyer has a special responsibility to protect the public when working in the securities area."[115] "[T]he Commission has repeatedly cautioned that 'the task of enforcing the securities laws rests in overwhelming measure on the bar's shoulders.'"[116]

2. *The Lawyer's Duty to Disclose*

Given the extensive role counsel plays in the registration process, and the SEC's reliance on the securities bar, the attorney's duty to disclose information is quite stringent compared to the duty to disclose in other areas of the law. This duty is embodied in SEC Rule 10b-5:

> *Employment of Manipulative and Deceptive Devices.* It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange, (1) to employ any device, scheme, or artifice to defraud, (2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or (3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.[117]

Two points of this Rule should not be overlooked. First, because the Rule applies to "any person," it imputes the same

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114. Douglas W. Hawes & Thomas J. Sherrard, *Reliance on Advice of Counsel as a Defense in Corporate and Securities Cases*, 62 VA. L. REV. 1, 5 (1976).

115. SODERQUIST, *supra* note 112, at 572.

116. *In re* Fields, 45 S.E.C. 262, 266 n.20 (1973), *aff'd without opinion sub nom.* Fields v. SEC, 495 F.2d 1075 (D.C. Cir. 1974) (citation omitted). *See also* SEC v. Spectrum, Ltd., 489 F.2d 535, 541-42 (2d Cir. 1973) ("The legal profession plays a unique and pivotal role in the effective implementation of the securities laws.").

117. 15 U.S.C.A. § 78j (West 1988).

disclosure obligations to issuers and to their counsel.[118] Second, the second clause of the Rule forbids untrue statements of a material fact or omissions of a material fact that would make *statements already made* misleading.[119] In other words, the Rule forbids half-truths. Putting these two points together, the Rule suggests that the attorney who makes representations to the SEC has the same disclosure obligations as the client.

When defining disclosure obligations, careful attention must be paid to the notion of "materiality." The Rule forbids untrue statements or omissions of a "material fact."[120] Consequently, cases interpreting the Rule have indicated the nature of the materiality standard. In *SEC v. National Student Marketing*,[121] a district court ruled that the materiality standard was objective. In *National Student Marketing*, the SEC brought suit for injunctive sanctions against a corporate director and counsel for securities violations relating to a corporate merger and the subsequent sale of stock.[122] Specifically, the court found counsel liable for aiding and abetting securities fraud by completing a merger that the lawyers knew had been approved on materially misleading information.[123] At the time of the closing, directors of the merging corporation received an unsigned "comfort letter"[124] revealing that the surviving corporation's interim financial statements were grossly inaccurate.[125] However, neither the corporate directors nor the attorneys disclosed the discrepancy to the shareholders.[126] The corporate directors reasoned that any delay for the purpose of resoliciting the shareholders would be impractical.[127] The directors also thought that "delay or abandonment of the merger would result in a decline in the value of both companies, thereby harming the shareholders and

118. *Id.*
119. *Id.*
120. *Id.*
121. 457 F. Supp. 682 (D.D.C. 1978).
122. *Id.* at 686-87, 699-700.
123. *Id.* at 712.
124. "A letter generally requested by securities underwriters to give 'comfort' on the financial information included in an SEC registration statement." BLACK'S LAW DICTIONARY 267 (6th ed. 1990).
125. SEC v. National Student Mktg., 457 F. Supp. 682, 691-97 (D.D.C. 1978).
126. *Id.* at 694, 696.
127. *Id.* at 694.

possibly subjecting the directors to lawsuits based on their failure to close the merger."[128]

In the subsequent lawsuit, the court defined the materiality standard as one that "contemplate[s] . . . a showing of a substantial likelihood that . . . the omitted fact would have assumed actual significance in the deliberations of the reasonable shareholder."[129] Based on that definition, the court determined that the information contained in the comfort letter was material and that the corporate directors should have disclosed it to the affected shareholders.[130] The court emphasized that although the directors may have made subjective "business judgments" to proceed with the closing without revealing the comfort letter to the shareholders, the question of materiality was an objective one, taken from the view of the reasonable shareholder.[131]

National Student Marketing is important for its enunciation of the materiality standard and serves as a landmark case because it addresses this question: To whom does a lawyer owe a duty to disclose?[132] The court answered this question by stating that the lawyer's duty to disclose extends to third persons.[133] With respect to corporate counsel, the court ruled that "at the very least [counsel was] required to speak out at the closing" of the merger and delay the closing until disclosure could be made and stockholders could be provided with corrected financial statements.[134] The court noted that "[t]heir silence was not only a breach of this duty to speak, but in addition lent the appearance of legitimacy to the closing."[135] Although the SEC also alleged that counsel had a duty to inform the SEC of its client's securities violations,[136] the court did not impose such a duty or give any reasons why such a duty would be improper.[137] In other words, the court declined to decide whether counsel had a duty to "blow the whistle" on their clients.

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128. *Id.*
129. *Id.* at 709 (quoting TSC Indus., Inc. v. Northway, Inc., 416 U.S. 438, 449 (1976)).
130. SEC v. National Student Mktg., 457 F. Supp. 682, 709 (D.D.C. 1978).
131. *Id.* at 709.
132. *Id.*
133. *Id.*
134. *Id.* at 713.
135. SEC v. National Student Mktg., 457 F. Supp. 682, 713 (D.D.C. 1978).
136. *Id.* at 712.
137. *Id.* at 713.

Unlike *National Student Marketing,* a recent case has curtailed an attorney's duty to disclose to third persons. In *In re William Carter & Charles J. Johnson, Jr.*,[138] the SEC reversed the decision of the administrative law judge, who suspended two attorneys from practicing before the SEC pursuant to 17 C.F.R. § 201.2(e).[139] Section 201.2(e) permits suspension of an attorney for "unethical or improper professional conduct."[140] In *Carter*, the SEC took the opportunity to interpret the rule and stated that its interpretation would be applicable to future cases of a similar nature.[141] According to the judge, a lawyer engages in "unethical or improper professional conduct" where he or she (1) has "significant responsibilities in the effectuation of a company's compliance with the disclosure requirements of the federal securities laws," (2) becomes aware that the client is "engaged in a substantial and continuing failure to satisfy those disclosure requirements," and (3) does not take "prompt steps to end the client's noncompliance."[142] The court concluded that counseling accurate disclosure is sufficient, even if the attorney's advice is not accepted.[143] However, when a lawyer concludes that his or her advice is not being followed, or even sought in good faith, and the client is involved in a continuing course of violating the securities laws, "the lawyer must take further, more affirmative steps in order to avoid the inference that he has been co-opted, willingly or unwillingly, into the scheme of non-disclosure."[144] The SEC stated that at that point, the attorney can resign or confront the board of directors,[145] but is not required to disclose the act publicly or to affected third parties.[146]

In sum, the central objective of a proceeding before the SEC is disclosure, and the lawyer's role in the proceeding is

138. [1981 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 82, 847 (Feb. 28, 1981).

139. *Id.* at 84, 146.

140. 17 C.F.R. § 201.2(e)(1)(ii) (1992).

141. *In re* William R. Carter and Charles J. Johnson, Jr., [1981 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84, 172-173 (Feb. 28, 1981).

142. *Id.* at 84, 172.

143. *Id.*

144. *Id.*

145. *In re* William R. Carter & Charles J. Johnson, Jr., [1981 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 82,847, at 84, 172 (Feb. 28, 1981).

146. *Id.*

indispensable.[147] Consequently, when making representations to the SEC, both the issuer and issuer's counsel are subject to the same high standard of disclosure.[148] This standard forbids half-truths[149] and is defined by an objective standard of materiality.[150] Moreover, if an attorney discovers that his or her client is committing a fraud, the duty to disclose does not require the attorney to notify the SEC or affected third persons, such as shareholders.[151] However, the duty to disclose *does* require that the attorney take affirmative action to correct the underlying problem, such as confronting the appropriate directors or resigning as counsel.[152] It is this proceeding and duty to disclose that the OTS argued was applicable to the Lincoln examination.[153]

D. *The Adversarial Proceeding*

1. *Nature of the Proceeding*

Ethical Consideration 7-19 of the Model Code of Professional Responsibility declares that "[o]ur legal system provides for the adjudication of disputes."[154] To that end, an adversarial proceeding has been designed. Partisan advocacy, by exchange of written pleadings or stipulations of counsel, is essential to narrow the issues for adjudication.[155] The parties also exchange information through the process of discovery.[156] At trial, "the advocate, by his zealous preparation and presentation of facts and law, enables the tribunal to come to the hearing with an open and neutral mind and to render impartial judgments."[157] Indeed, Canon Seven of the Model Code requires that a "lawyer should represent a client zealously within the bounds of the law."[158] The zealous represen-

147. *See supra* notes 103-14.
148. *See supra* text accompanying note 117.
149. *See supra* text accompanying note 117.
150. *See supra* text accompanying notes 129-31.
151. *See supra* text accompanying note 146.
152. *See supra* text accompanying notes 142-45.
153. *See supra* text accompanying notes 79-83.
154. MODEL CODE OF PROFESSIONAL RESPONSIBILITY EC 7-19 (1981).
155. American Bar Association, *Professional Responsibility: Report of the Joint Conference*, 44 A.B.A. J. 1159, 1160 (1958).
156. *See infra* text accompanying notes 161-69.
157. MODEL CODE OF PROFESSIONAL RESPONSIBILITY EC 7-19 (1981).
158. MODEL CODE OF PROFESSIONAL RESPONSIBILITY Canon 7 (1981). This general rule has many corollaries. "A lawyer shall not intentionally fail to seek the lawful objectives of his client through reasonably available means." MODEL

tation of both sides presents the tribunal with two contrasting versions of the facts and issues so that the truth emerges from the process.[159] Given the complexity of substantive, evidentiary, and procedural law at trial, zealous representation is also essential to protect the client's interests so that no person may be deprived of life or liberty without due process of law.[160]

2. *The Lawyer's Duty to Disclose*

A proper discussion of the lawyer's duty to disclose in adversarial proceedings begins with discovery. Five major devices are available for discovery: depositions upon oral examinations or written questions; written interrogatories; production of documents or things or permission to enter upon land or other property for inspection and other purposes; physical and mental examinations; and requests for admissions.[161]

The purposes of discovery are manifold. Discovery promotes early and thorough disclosure of information by all sides and thus furthers the isolation of issues and determination of material and undisputed facts.[162] As the issues for adjudication become more clear, the parties may supplement their pleadings.[163] To some extent, discovery equalizes the investigative resources of both sides without allowing one side to gain undue advantage.[164] Limited exploration into the adversary's documentation and evidence allows each party to discover its opponent's perceptions and facts of the case.[165] Discovery preserves tangible evidence and documents oral testimony.[166] It also promotes negotiated settle-

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CODE OF PROFESSIONAL RESPONSIBILITY DR 7-101(A)(1) (1981). Nor should a lawyer "prejudice or damage his client during the course of the professional relationship." MODEL CODE OF PROFESSIONAL RESPONSIBILITY DR 7-101(A)(3) (1981). Neither should a lawyer break the law or assist the client to do so. MODEL CODE OF PROFESSIONAL RESPONSIBILITY DR 7-102 (1981).

159. Ellen E. Sward, *Values, Ideology, and the Evolution of the Adversary System,* 64 IND. L.J. 301, 316-17 (1989).

160. Powell v. Alabama, 287 U.S. 45, 68-69 (1932).

161. ROGER S. HAYDOCK & DAVID F. HERR, DISCOVERY PRACTICE 14 (2d ed. 1988).

162. *Id.* at 10.

163. *Id.*

164. *Id.*

165. *Id.* at 11.

166. *Id.*

ments and fosters trial verdicts based on accurate presentations and informal arguments, rather than verdicts based on surmise and surprise.[167] If the process is not abused, discovery provides an economical method for dispute resolution.[168]

However, in spite of these traditional goals, "[t]here are many standard devices used by litigators to resist the disclosure of information and to mislead the opponent through their responses to interrogatories, requests for admissions, and demands for documents."[169] For instance, counsel who responds to a document demand request may construe all inquiries and requests as narrowly as possible, thus limiting the amount of useful information that must be surrendered.[170] "The rules of professional responsibility lend important support to responding counsel in such exercises of semantic narrowness. Ethical Consideration 7-3 to Canon 7 of the ABA Code of Professional Responsibility directs litigating attorneys to resolve all 'doubts as to the bounds of the law' in favor of their clients."[171] The ethical rules thus demand that any ambiguity about the scope of an interrogatory or a document production be resolved narrowly and against disclosure.[172] In the absence of judicial intervention, it is the responding attorney who decides what constitutes ambiguity.[173] To be certain, "[t]he attorney will feel considerable pressure to adopt an aggressively broad definition of the term 'doubt' whenever doing so might benefit the client," either by revealing less information, misleading an opponent, or inflating the fee.[174] Indeed, resolving all doubt in favor of nondisclosure may allow aggressive counsel to completely refuse to respond to written requests that are not free of all ambiguity, imprecision, overbreadth, irrelevance, or other technical deficiency.[175] Even if the request is faultless, counsel may still refuse to respond to interrogatories or document production requests until compelled to do so.[176] "At least

167. *Id.*
168. *Id.*
169. Wayne D. Brazil, *The Adversary Character of Civil Discovery: A Critique and Proposals for Change,* 31 VAND. L. REV. 1295, 1323 (1978).
170. *Id.*
171. *Id.*
172. *Id.*
173. *Id.*
174. *Id.*
175. *Id.* at 1324.
176. *Id.* at 1325.

among seasoned litigators the fear of sanctions for missing one deadline is not great."[177] And when a response to a document production must be given, litigators may sometimes conceal damaging information by burying significant documents in mounds of irrelevant or innocuous materials.[178]

Oral depositions present a host of other tactics used by lawyers to limit and distort the information flow during discovery. "The adversarial objective of attorneys whose clients or witnesses are being deposed is to limit to the greatest extent possible the information divulged."[179] For example, attorneys can conduct mock depositions to coach their clients to give the least troublesome answers[180] and otherwise instruct them in the art of nondisclosure.[181]

The zealous advocacy that fuels these techniques to limit disclosure is not limited to discovery, but continues into the trial itself. For example, Disciplinary Rule 7-102(A) of the Model Code of Professional Responsibility allows the lawyer to advance any "claim or defense if it can be supported by [a] good-faith argument for an extension, modification, or reversal of existing law."[182] One commentator has noted that:

> [g]iven the folklore of zealous advocacy and the admonition to resolve all doubts in the client's behalf, it is a rare lawyer who could not devise some good-faith argument for

177. *Id.*
178. *Id.*
179. *Id.* at 1330-31.
180. *Id.* at 1331.
181. *Id.*

> A recitation of the standard admonitions attorneys give their clients before depositions graphically illustrates how preoccupied litigators can be with resisting disclosure: (1) never volunteer information or help attorneys who are posing questions; (2) ignore the long silences and expectant faces attorneys will use to pressure you into continuing to speak; (3) answer questions with the fewest words and least elaboration that is consistent with self-serving consistency; (4) never interrupt the examining attorney before he has completed a question (to do so might provide an answer to a question the attorney had not thought to ask); (5) never edit or help clarify a confusing question (instead, simply say you do not understand); (6) always pause before answering in order to think and to give your attorney an opportunity to object; and (7) always listen carefully to your attorney's objections because they may contain directives or clues about how to respond to a line of questions. The purpose of such instructions to witnesses obviously is not to ensure that all the relevant information they have will be disclosed during their depositions.

Id.

182. MODEL CODE OF PROFESSIONAL RESPONSIBLITY DR 7-102(A) (1981).

> the flimsiest of claims. Because DR 7-102(A) uses an essentially subjective, good-faith, standard, the remote risk of disciplinary action could be countered easily either with a 'pure heart, empty head' defense or by arguing that the lawyer made a good-faith error of judgment. . . . When this standard is applied to guide essentially private decisions by a lawyer, based upon facts that are not readily observable to others, the rules are largely self-executing. The overzealous lawyer can, with relative impunity, violate a rule or stretch its interpretation so as to justify doubtful conduct.[183]

Given this standard, a lawyer in an adversarial proceeding has wide latitude in presenting his or her claims and defenses. Unlike practice before the SEC, where the attorney is controlled by an *objectively* determined materiality standard,[184] the lawyer in an adversarial proceeding need only justify his or her claims and defenses by a *subjective,* good-faith argument. Thus, a zealous advocate can stretch the applicable rules of evidence to limit the disclosure of damaging information.

These litigation techniques, because they are peculiar to the adversarial proceeding, may seem to belong to the attorney. However, because a lawyer represents a client and does not act independently, it is more appropriate to think of these tactics as belonging to the client. This point may also be observed in a client's use of privileges to avoid disclosure.

In criminal proceedings,[185] a defendant can prevent disclosures by invoking the Fifth Amendment privilege against self-incrimination, which states that "[n]o person . . . shall be compelled in any criminal case to be a witness against himself . . . ."[186] Two rationales support the privilege: systemic and individual.[187] Systemic justifications suggest that the

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183. David B. Wilkins, *Legal Realism for Lawyers,* 104 HARV. L. REV. 468, 475 (1990).

184. *See supra* text accompanying notes 129-31.

185. Criminal proceedings impose different rights and duties for the defense and prosecution. *See, e.g.,* WAYNE R. LAFAVE & JEROLD H. ISRAEL, CRIMINAL PROCEDURE 706-61 (1985). However, this comment's discussion is limited to the defense's duty to disclose. The limit is appropriate because the criminal defendant is analogous to the bank in an OTS examination, each being the subject of governmental investigation.

186. U.S. CONST. amend. V.

187. David Dolinko, *Is There a Rationale for the Privilege Against Self-Incrimination?,* 33 U.C.L.A. L. REV. 1063, 1065 (1986) ("*Systemic rationales* are policies their proponents believe to be crucial to our particular kind of criminal

privilege "encourages third-party witnesses to appear and testify by removing the fear that they might be compelled to incriminate themselves" and that the privilege "'remov[es] the temptation to employ short cuts to conviction that demean official integrity.'"[188] "Individual rationales include the [notion] that compelled self-incrimination works an unacceptable cruelty or invasion of privacy."[189] Also important is the "respect for the inviolability of the human personality"[190] and the idea that punishing an individual for silence or perjury when he or she is in a situation that compels false testimony is an "'intolerable invasion of his [or her] personal dignity.'"[191]

The privilege against self-incrimination typically belongs to the defendant. In general, "one party may not assert the Fifth Amendment privilege of another because the latter is not being *compelled* when testimony or documents are taken from the former."[192] For example, "when a person's papers are in the possession of a third party, their seizure is not barred by the Fifth Amendment, even when that party is an agent of the person."[193] However, "if a person enjoys Fifth Amendment protection for certain documents, and those documents are transferred to an attorney 'for the purpose of obtaining legal advice,' then the attorney may assert the Fifth Amendment claim for the client's protection" via the attorney-client privilege.[194]

In addition to the privilege against self-incrimination, another way a defendant can prevent disclosure is to not make discovery requests of the prosecution. As in the federal courts, in some jurisdictions, the prosecution is only allowed conditional discovery.[195] In other words, "the prosecutor cannot simply institute a demand for disclosure of the items

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justice system. *Individual rationales* are principles claimed to be entailed by a proper understanding of human rights or by a proper respect for human dignity and individuality.").

188. *Id.* at 1065-66.

189. *Id.*

190. *Id.*

191. *Id.* at 1065 (citation omitted).

192. CHARLES H. WHITEBREAD & CHRISTOPHER SLOBOGIN, CRIMINAL PROCEDURE 324 (2d ed. 1986). *See also supra* text accompanying note 186.

193. *Id.* at 325 (citation omitted).

194. *Id.* (citation omitted).

195. CHARLES E. TORCIA, WHARTON'S CRIMINAL PROCEDURE § 387 (12th ed. 1975).

specified as discoverable. The prosecutor may only insist upon disclosure if the defendant has demanded and received disclosure of material of the same general character."[196] A defendant may therefore foreclose the prosecution's discovery by not exercising his or her own right to discovery.[197]

Given the criminal defendant's privilege against self-incrimination, and his or her right to limit discovery in several jurisdictions, defendants have a fairly low duty to disclose information to the prosecution.[198] By extension, counsel, when representing a criminal defendant, has the same low duty to disclose. In other words, the lawyer's low duty to disclose derives from the rights and privileges of the client.[199]

In contrast to a criminal proceeding, the ability of a party to a civil proceeding to avoid disclosure is more limited. The privilege against self-incrimination is frequently unavailable to the party in a civil action. First, the Fifth Amendment explicitly states that "[n]o person shall . . . be compelled in any *criminal* case to be a witness against himself . . . ."[200] Second, the privilege has been denied to corporations, associations, non-personal partnerships, and the employees or agents of such collective groups.[201] "The nature of the capacity of the person claiming the privilege—either personal or representational—determines whether the claim is applicable. If the former, it applies; if the latter, it does not apply."[202]

One of the reasons underlying the restriction of this constitutional privilege to natural individuals acting in their own private capacity is that the scope and nature of the economic activities of incorporated and unincorporated organizations and their representatives demand that the constitutional power of the federal and state governments be able to

196. LAFAVE & ISRAEL, *supra* note 185, at 746. *See also, e.g.*, Federal Rule 16(b)(1)(B) (permitting the prosecution to seek from the defense scientific reports made in connection with the case only after the defendant has used the corresponding provision in Federal Rule 16(a)(1)(D) to obtain scientific reports from the government).

197. LAFAVE & ISRAEL, supra note 185, at 746-47.

198. *See supra* text accompanying notes 185-96.

199. Stuart M. Gerson, *When Lawyers Must Disclose*, 138 CHI. DAILY L. BULL. 6 (1992) (citation omitted).

200. *See supra* note 186 and accompanying text (emphasis added).

201. *See, e.g.*, HAYDOCK & HERR, *supra* note 161, at 324; WHITEBREAD & SLOBOGIN, *supra* note 192, at 118.

202. *See* HAYDOCK & HERR, *supra* note 161, at 118 (citation omitted).

regulate those activities effectively.[203] In general, evidence of wrongdoing of an organization (or its representative) will usually be found in the official records and documents of the organization.[204] "Were the cloak of the privilege to be thrown around these impersonal records and documents, effective enforcement of many federal and state laws would be impossible."[205] As the Supreme Court noted, "[t]he framers of the constitutional guarantee against compulsory self-disclosure, who were interested primarily in protecting individual civil liberties, cannot be said to have intended the privilege to be available to protect economic or other interests of such organizations so as to nullify appropriate governmental regulations."[206] Moreover, even when individuals are parties to lawsuits involving private issues, the same concern for individual dignity is not presented.

Unlike the privilege against self-incrimination, the attorney-client privilege can be claimed by corporations as well as individuals.[207] "The privilege encourages 'full and frank communication between attorneys and their clients and promotes broader public interest in the observance of law and administration of justice.'"[208] The privilege recognizes that "sound legal advice or advocacy depends upon the lawyer being fully informed by the client."[209] The attorney-client privilege "rests on the need for the advocate and counselor to know all that relates to a client's reasons for seeking representation if the professional mission is to be carried out."[210] Thus, the privilege preserves the integrity of relationships.[211] Countervailing considerations include the government's interest in effective law enforcement and the public's right to "'every man's evidence.'"[212]

As with the other privileges, the attorney-client privilege belongs to, and is for the benefit of, the client.[213] The client

203. United States v. White, 322 U.S. 694, 700 (1944).
204. *Id.*
205. *Id.*
206. *Id.*
207. HAYDOCK & HERR, *supra* note 161, at 135.
208. *Id.* at 133 (citation omitted).
209. *Id.*
210. *Id.*
211. *Id.* at 116.
212. *Id* (citation omitted).
213. *Id.* at 142.

determines when the privilege is to be asserted or waived.[214] An attorney may raise the privilege on a client's behalf and may be duty-bound to raise it to protect confidential communications, but if the client waives the privilege, the attorney is not allowed to assert it.[215]

The client cannot use the privilege to avoid his or her own duty to disclose. A client can be questioned about what he or she knows, even though that knowledge has been communicated to his or her lawyer, unless, of course, there exists another claim of privilege, such as self-incrimination.[216] The fact that a client communicates certain information to an attorney does not cloak that information with the privilege.[217] "The privilege only protects disclosure of communications; it does not protect disclosure of the underlying facts by those who communicated with the attorney."[218] For instance, "'[t]he client cannot be compelled to answer the question, "What did you say or write to your attorney?" [But the client] may not refuse to disclose any relevant fact within his knowledge merely because he incorporated a statement of such fact into his communication to his attorney.'"[219] Consequently, given that the privileges available to a party in a civil proceeding offer less protection than the privileges available to the criminal defendant,[220] the attorney who represents a client in a civil suit has a greater duty to disclose information to the opposing party. The greater duty exists because, like a criminal proceeding, the lawyer's duty to disclose in a civil proceeding derives from the rights and privileges of the client.[221]

There is one more aspect of the adversarial proceeding that affects a lawyer's duty to disclose that is perhaps the most important aspect and yet which is so fundamental to the system that it could easily be overlooked. In general, the zealous advocate has no duty to disclose facts adverse to his or her client.[222] Although the ethical rules mandate that an

214. *Id.*
215. *Id.*
216. *Id.* at 138.
217. *Id.*
218. *Id.*
219. *Id.* (citation omitted).
220. *See supra* text accompanying notes 203-06.
221. *See supra* text accompanying notes 213-15.
222. *See infra* text accompanying notes 223-24.

attorney disclose any authority adverse to his or her case,[223] "[g]enerally a lawyer has no obligation to disclose facts helpful to the other side or even to correct a misimpression the lawyer is not personally responsible for creating."[224] The adversarial system is designed to produce truth through the presentation of two contrasting views of the facts and issues.[225] Thus, a zealous advocate has no duty to volunteer information or ensure that the court has all relevant information at its disposal. Rather, the burden is on opposing counsel to find and present adverse facts independently or to construct discovery requests with sufficient particularity to require disclosure.

Exceptions to this general rule apply, however, when the lawyer discovers that his or her client is committing a crime or fraud. Both the Model Code and the Model Rules prohibit a lawyer from counseling or assisting a client in perpetrating a crime or fraud.[226] For instance, Comment to Model Rule 3.3 provides that:

> [i]f perjured testimony or false evidence has been offered, the advocate's proper course ordinarily is to remonstrate with the client confidentially. If that fails, the advocate should seek to withdraw if that will remedy the situation. If withdrawal will not remedy the situation or is impossible, the advocate should make disclosure to the court. It is for the court then to determine what should be done—making a statement about the matter to the trier of fact, ordering a mistrial or perhaps nothing.[227]

In comparison, Disciplinary Rule 7-102(B)(1) of the Model Code requires disclosure of the fraud to the affected person or tribunal, "except when the information is protected

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223. Mark C. Morril, *Guidelines for Litigators, in* LEGAL ETHICS 1990: WHAT EVERY LAWYER NEEDS TO KNOW 649, 659 (PLI Litig. and Admin. Practice Course Handbook Series No. H4-5099 (1990)).

224. *Id.* at 663. "However, in some instances, a lawyer's silence may be found to constitute fraud or deceit on the court." *Id.* (citing Daniel v. Penrod Drilling Co., 393 F. Supp. 1056 (E.D. L.A. 1975) (failing to reveal secret settlement rendered case moot); *see also* Hutton v. Fisher, 359 F.2d 913 (3d Cir. 1966) (information material to entry of default judgment); Toledo Bar Ass'n v. Fell, 364 N.E.2d 872 (1977) (death of client pendente lite)); MODEL RULES OF PROFESSIONAL CONDUCT 3.3(d) (1992) (in an ex parte proceeding, the lawyer must disclose all facts required to enable the tribunal to make an informed decision).

225. *See supra* text accompanying note 159.

226. Morril, *supra* note 223, at 664.

227. MODEL RULES OF PROFESSIONAL CONDUCT Rule 3.3(d) cmt. (1992).

as a privileged communication."[228] But as the Model Rules indicate, "[t]his qualification may be empty, for the rule of attorney-client privilege has been construed to exclude communications that further a crime, including the crime of perjury."[229] Moreover, discerning a lawyer's duty to disclose in the case of a crime or fraud can become difficult in criminal proceedings. As the Model Rules note:

> the definition of the lawyer's ethical duty in such a situation may be qualified by constitutional provisions for due process and the right to counsel in criminal cases. In some jurisdictions these provisions have been construed to require that counsel present an accused as a witness if the accused wishes to testify, even if counsel knows the testimony will be false.[230]

In summary, an adversarial proceeding contemplates partisan advocacy before a neutral tribunal in order to narrow the issues of a dispute for adjudication.[231] Ideally, zealous representation by counsel when presenting the tribunal with two contrasting versions of the facts and issues causes truth to emerge.[232] Representation is also essential to protect the client's personal and pecuniary interests.[233]

Both before and during trial, there are many standard devices used by litigators to limit or distort the flow of information.[234] Before trial, a zealous advocate can construe discovery requests narrowly,[235] refuse to reply to requests that are not properly tailored,[236] stretch deadlines,[237] bury significant documents in mounds of material,[238] and instruct a deposed client in the art of nondisclosure.[239] An attorney can also stretch applicable evidence rules by making a good-faith argument for an extension, modification, or reversal of ex-

228. MODEL CODE OF PROFESSIONAL RESPONSIBILITY DR 7-102(B)(1) (1981).

229. MODEL RULES OF PROFESSIONAL CONDUCT Rule 3.3(d) Model Code comparison (1992).

230. *Id.*

231. *See supra* text accompanying notes 154-55.

232. *See supra* text accompanying notes 157-59.

233. *See supra* text accompanying note 160.

234. *See supra* text accompanying note 169.

235. *See supra* text accompanying notes 170-74.

236. *See supra* text accompanying note 175.

237. *See supra* text accompanying notes 176-77.

238. *See supra* text accompanying note 178.

239. *See supra* text accompanying note 181.

isting law.[240] These tactics should be construed as belonging to the client, similar to the attorney-client privilege.

In the criminal context, the criminal defendant's privilege against self-incrimination and his or her right to limit discovery (in jurisdictions that practice conditional discovery) protect the defendant from disclosure.[241] These rights rest solely with the criminal defendant, and by asserting these rights and privileges of the defendant, defense counsel has the same low duty to disclose.[242] In the civil context, the attorney's duty to disclose is much higher because the client frequently cannot make use of the privilege against self-incrimination,[243] so he or she must rely on the attorney-client privilege.[244] Similar to the privileges available to the criminal defendant, the attorney-client privilege belongs solely to the client.[245] This privilege, however, cannot be used to avoid the client's own duty to disclose.[246]

Most importantly, a zealous advocate generally has no obligation to disclose facts helpful to the other side or even to correct a misimpression that the lawyer is not personally responsible for creating.[247] The adversarial system is designed to produce truth through the presentation of two contrasting views of the facts and issues.[248] Consequently, a lawyer in a adversarial proceeding has no duty to volunteer information or to ensure that the court has all the relevant facts in order to issue a ruling. Exceptions might apply where the client is committing a crime or fraud, in which case an attorney has a duty to remonstrate with the client, and may have a further duty to withdraw or to disclose the information to the court.[249]

240. *See supra* text accompanying notes 182-84.
241. *See supra* text accompanying notes 185-96.
242. *See supra* text accompanying notes 198-99.
243. *See supra* text accompanying notes 200-06.
244. *See supra* text accompanying note 207.
245. *See supra* text accompanying notes 213-15.
246. *See supra* text accompanying notes 217-19.
247. *See supra* text accompanying note 224.
248. *See supra* text accompanying note 225.
249. *See supra* text accompanying notes 226-29.

III. ANALYSIS

Now that the respective natures of a savings and loan examination,[250] a proceeding before the SEC,[251] and an adversarial proceeding[252] have been defined, one can determine whether an examination is more SEC-like or adversarial. Once that determination is made, conclusions can then be drawn regarding an attorney's proper role in an examination and what standards of disclosure should apply.

A. *Examinations and Proceedings Before the SEC*

The feature distinguishing an OTS examination from a proceeding before the SEC is the reliance of the regulating agency on the attorney in each process. First, the SEC relies heavily on the attorney to provide facts to the SEC because the attorney plays an indispensable role in helping the issuer make judgments as to materiality and compliance with the requirements of the registration process.[253] Indeed, counsel is often the principal draftsperson of the registration statement.[254] In contrast, the OTS, by conducting its own investigation and having unlimited access to the bank's files and officers,[255] does not need to rely on the judgments and drafting abilities of an attorney.

Second, the SEC relies heavily on the attorney because securities transactions generally will not proceed without an attorney. In contrast, the OTS can complete an examination without the aid of an attorney.[256] And third, because the SEC's enforcement resources are "wholly insufficient" to police a significant portion of securities transactions, the SEC states that it must rely heavily on the attorney to implement its own policies.[257] The OTS has made no such statement regarding the implementation of *its* policies; rather, reliance is placed on the examination system to promote the safety and soundness of federally insured financial institutions.

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250. *See supra* part II.A.1.
251. *See supra* part II.C.1.
252. *See supra* part II.D.1.
253. *See supra* text accompanying notes 106-14.
254. *See supra* text accompanying note 111.
255. *See supra* text accompanying notes 42-44.
256. *See supra* text accompanying notes 112-13.
257. *See supra* text accompanying notes 115-16.

These distinctions suggest that it is unnecessary for an attorney to make representations to the regulatory agency *at all*. As previously noted, the presence of the lawyer in securities transactions is indispensable to both the regulated companies and the regulators.[258] Without an attorney, there is no one with adequate expertise to investigate, coordinate, and provide the SEC with all the facts material to the sale of a security.[259] Hence, securities transactions would not proceed and the SEC would have difficulty implementing its own policies.[260] In contrast, there is no similar reliance on lawyers in an OTS examination. Consequently, there is no great need for an attorney who represents a financial institution to make representations to the regulatory agency during an examination.

This does not suggest, however, that there is no need at all for counsel in the OTS examination proceeding. Nor does it suggest that counsel should *never* make representations to the regulatory agency. The following subsections explore what counsel's role should be in an examination and what consequences result when an attorney chooses to make representations to the regulatory agency.[261]

B. *Examinations and Adversarial Proceedings*

In contrast to an adversarial proceeding, an OTS examination is not the "adjudication of a dispute."[262] In an examination, there are not two parties presenting opposing views of the issues and facts. Although an attorney representing a financial institution could indeed be a zealous advocate *for* the financial institution, there is no one to be a zealous advocate *against* the financial institution. Consequently, because there is no presentation of contrasting facts and issues, many of the goals of the adversarial process are inapplicable to the examination. Partisan advocacy, by exchange of written pleadings or stipulations of counsel, is of no use to "narrow the issues for adjudication."[263] Furthermore, because the examination is not an adjudication of a dispute, there is no in-

258. *See supra* text accompanying notes 113-16.
259. *See supra* text accompanying notes 106-16
260. *See supra* text accompanying notes 106-16.
261. *See infra* text accompanying notes 266-70.
262. *See supra* text accompanying note 152.
263. *See supra* text accompanying note 155.

dependent, neutral third party present during the examination as there is in an adversarial proceeding.[264] In short, an OTS examination is *not* a trial. Consequently, zealous advocacy is *not* vital to protect the due process rights of the financial institution. The OTS does not seek to deprive the financial institution of life, liberty, or property. Rather, the purpose of the OTS is to implement corrective measures and promote the safety and soundness of the institution.[265]

Zealous advocacy during an OTS examination may not only be inappropriate, but it may also hinder the goals of the examination itself. Zealous advocacy may disrupt a regulatory agency's examination with tactics common to the adversarial process, such as the threat or actual invocation of legal proceedings.[266] "The examination process depends upon access to the books, records and information of the thrift institution. Regulators demand such access. Indeed, it is probable that our current system of financial institution regulation could not function without such access."[267]

Concluding that zealous advocacy is inappropriate during an examination does not preclude enforcing the legal rights of a financial institution in a court of law when there is a good-faith reason to do so. In this respect, an attorney, without obstructing the process of an examination, can act as a zealous watchdog to monitor the examination process to ensure that the regulating agency does not overstep its authority or abuse its discretion.

Indeed, a lawyer's services are not entirely inappropriate during an examination. Although a zealous *advocate* may be inappropriate, a zealous *adviser* is not. Ethical Consideration 7-3 of the Model Code of Professional Responsibility observes that "[i]n asserting a position on behalf of his client, an advocate for the most part deals with past conduct and must take the facts as he finds them."[268] "By contrast, a lawyer serving as adviser primarily assists his client in determining the course of future conduct and relationships."[269] Given these two functions of an attorney, it is clear that an advisory

264. *See supra* text accompanying note 159.
265. *See supra* text accompanying notes 39-48.
266. *See* Sporkin, *supra* note 15.
267. Douglas & Train, *supra* note 65.
268. MODEL CODE OF PROFESSIONAL RESPONSIBILITY EC 7-3 (1981).
269. *Id.*

role is more consistent with the nature of an OTS examination because the purpose of an examination is to avoid future problems, not to assign responsibility for past injury.[270] Indeed, "much of the work of regulatory counsel involves digesting complicated facts, considering complex statutes and regulations, and formulating appropriate advice."[271]

C. *The Nature of the Proceeding and the Duty to Disclose*

The analysis in the previous subsection suggests that an attorney need not make representations to the regulatory agency during an examination (*i.e.*, the attorney should not play the role of a traditional advocate), but that the attorney should be an adviser and watchdog.[272] This does not suggest that an attorney should never make representations to the regulatory agency.[273] Indeed, a financial institution is free to explicitly engage a lawyer to this effect. But if an attorney *does* choose to make representations to the regulatory agency in an examination, what standard of disclosure should apply?

The nature of the examination proceeding answers this question. When determining the lawyer's duty to disclose, a primary consideration is the client's duty to disclose. The financial institution in an examination has a duty to reveal all material relevant to the regulator's decision.[274] This duty is similar to that of an issuer in an SEC proceeding[275] and unlike that of a party to an adversarial proceeding.[276] The financial institution's duty to disclose is logical considering the nature of the examination proceeding. As in the SEC proceeding,[277] there is only one party presenting facts to the regulatory agency.[278] Thus, the burden rests with the fact-producing party to disclose all material information to render a

270. In some sense, of course, an OTS examination is backward-looking. For instance, the OTS will look at a bank's past record of underwriting practices. *See supra* text accompanying notes 45-48. However, the primary purpose of such an inquiry is to determine the present safety and soundness of the institution and to ensure its continued stability. *See supra* text accompanying notes 45-48.

271. Douglas & Train, *supra* note 65.

272. *See* discussion *supra* parts III.A-B.

273. *See generally supra* text accompanying note 261.

274. *See supra* text accompanying note 50.

275. *See supra* text accompanying notes 117-31.

276. *See supra* text accompanying part II.D.2.

277. *See* discussion *supra* part III.C.

278. *See* discussion *supra* part II.A.1.

complete factual picture. In contrast to an adversarial proceeding, each party need present only facts most favorable to the client. The burden is on opposing counsel to bring forth adverse facts or to force their disclosure with properly tailored discovery requests.

The relationship between the client's duty to disclose and the lawyer's duty to disclose is evident when different proceedings are considered. Different proceedings give parties different rights and duties due to the policies served by the proceedings. In the criminal context, defendants have a relatively low duty to disclose because their personal liberty is at stake.[279] In the civil context, economic interests are at stake and personal liberty is less threatened; therefore, defendants have a higher duty to disclose.[280] Rather than rely on the privilege against self-incrimination, civil defendants must rely on less protective privileges, such as that between attorney and client.[281] For the issuer filing a prospectus with the SEC, the duty to disclose is great.[282] Consequently, an issuer has a duty to disclose all material information relevant to an investor's decision.[283] "Materiality" is defined by an objective standard, which is higher than the more subjective standard of disclosure used in adversarial proceedings.[284]

Because the lawyer's rights and duties derive from the party the lawyer represents, different proceedings indirectly give lawyers different rights and duties. In other words, an attorney can prevent disclosure only to the extent the client can rely on a privilege. As the nature of the proceeding changes, a client's ability to rely on privileges against disclosure changes. As a client's ability to rely on privileges against disclosure decreases, the attorney's duty to disclose increases.

Policy supports this conclusion. In the civil context, the client cannot avoid disclosure by cloaking information in the attorney-client privilege.[285] Similarly, the financial institution undergoing an examination by the OTS should not be able to escape its own duty to disclose by hiring litigation

279. *See supra* text accompanying notes 185-96.
280. *See supra* text accompanying notes 200-06.
281. *See supra* text accompanying note 207.
282. *See* discussion *supra* part II.C.1.
283. *See supra* text accompanying notes 117, 129-31.
284. *See supra* text accompanying notes 129-31.
285. *See supra* text accompanying notes 216-19.

counsel and hiding behind the attorney-client privilege. As Charles Wolfram observes, "[h]iring a 'litigator' to do work customarily performed by 'regulatory counsel' does not by itself replace the Marquis of Queensbury rules with the rules of war."[286] The Model Code of Professional Responsibility demands no less: "Because it interferes with the proper administration of justice, a lawyer should not suppress evidence that he *or his client* has a legal obligation to reveal or produce."[287]

Concluding that the financial institution undergoing an OTS examination cannot change its own duty to disclose does not hold equally true for the lawyer. As previously noted, it is unnecessary for the lawyer undergoing an examination to make representations to the regulatory agency.[288] If, then, the lawyer is content to serve as an adviser or watchdog, making no such representations, disclosure obligations applicable to the financial institution should not apply to the lawyer. This duty is confirmed by 12 C.F.R. Section 563.180(b), which requires disclosure of all material information regarding oral or written *statements* made to the OTS or other similar entities auditing an insured institution.[289] Thus, if the lawyer does not make statements to the regulatory agency, he or she has a relatively low duty to disclose compared to that of the financial institution.

However, if the lawyer chooses to make representations to the regulatory agency, his or her duty to disclose changes because the nature of the proceeding changes with respect to the lawyer. In this scenario, the lawyer is more akin to the attorney who becomes the provider of facts for an issuer in an SEC proceeding.[290] Consequently, like an attorney in an SEC proceeding, an attorney who becomes the provider of facts for a financial institution assumes the same disclosure obligations of his or her client.

The duty works no hardship on the attorney-client privilege, as some have feared.[291] For the financial institution undergoing an examination and making representations to the

286. Wolfram, *supra* note 11, at 60.

287. MODEL CODE OF PROFESSIONAL RESPONSIBILITY EC 7-27 (1981) (emphasis added).

288. *See supra* text accompanying notes 160-61.

289. *See supra* text accompanying note 50.

290. *See supra* text accompanying notes 106-14.

291. *See* Labaton, *supra* note 17.

regulatory agency, the attorney-client privilege, for the most part, is not available.[292] Like the issuer in an SEC proceeding, a financial institution is under a duty to reveal all information material to the regulator's evaluation.[293] Similarly, because the lawyer representing facts to the regulatory agency on behalf of a financial institution can only prevent disclosure to the extent that the client institution can rely on some privilege, the lawyer is under the same disclosure obligations as the client.

D. *Lincoln's Examination and Hypothetical Examples Revisited*

When Lincoln hired a litigator to "defend it"[294] in the examination, Lincoln tried to define the nature of the proceeding through the rights and duties of the attorney. Specifically, by hiring litigation counsel, Lincoln attempted to characterize the OTS examination as an adversarial proceeding so that Lincoln's duty to disclose would be lower. However, it is the nature of the proceeding that defines the rights and duties of the client, which in turn defines the rights and duties of the attorney.[295] Thus, Kaye, Scholer's use of privileges available in an adversarial proceeding was inappropriate and obstructionist because an OTS examination is not a trial.[296] When Lincoln sought to hire the firm as litigators,[297] Kaye, Scholer should have advised Lincoln that the proper role of an attorney in an OTS examination is that of an adviser and watchdog, not that of an advocate.[298] By becoming Lincoln's advocate and making representations to the OTS,[299] Kaye, Scholer became the provider of facts to the OTS and thus subjected itself to the same materiality standards of disclosure as the financial institution itself.[300] Thus, when Kaye, Scholer made representations to the OTS concerning Lincoln's financial posture, Kaye, Scholer had a duty to reveal all material information relating to Lincoln's finan-

292. *See* discussion *supra* part II.A.
293. *See supra* text accompanying note 50.
294. *See supra* text accompanying note 64.
295. *See* discussion *supra* part III.C.
296. *See supra* text accompanying notes 221-65.
297. *See supra* text accompanying note 64.
298. *See* discussion *supra* part III.B.
299. *See supra* text accompanying notes 64-65.
300. *See* discussion *supra* part III.C.

cial posture, including that Lincoln's auditing firm at one time stated that "Lincoln looks like most of the other S&L's that have failed" and is "a high-risk client."[301]

Given that the attorney who makes representations to the OTS is subject to the same standards of disclosure as the financial institution, the answers to the hypotheticals in which the attorney makes representations to the regulatory agency are straightforward. Of course, in the first hypothetical example, in which Lawyer lies to the regulatory agency,[302] he or she is personally liable, regardless of how the proceeding is characterized. The second hypothetical example, in which the Lawyer tells the truth, but knowingly omits a material fact,[303] also imputes liability to the attorney because he or she, by making representations to the regulatory agency, is subject to the materiality standards of the financial institution.[304]

The third hypothetical example, in which Lawyer tells the truth, unknowingly omitting a material fact when "red flags" beg further inquiry,[305] is a tougher question. Here, a comparison with the attorney filing a prospectus with the SEC is instructive. In that scenario, an attorney, being the "quarterback" of the filing process,[306] has a duty to make a "due diligence" inquiry, and a failure to do so can create personal liability.[307] Because a regulatory examination, like an SEC filing, has disclosure as its central objective, an attorney in an examination should be under a similar duty to make a "due diligence" inquiry for his or her representations to the regulatory agency.[308] Consequently, Lawyer in the third hypothetical example should be liable for failing to disclose.

The fourth hypothetical example is similar to the third, except that no "red flags" beg further inquiry.[309] Consequently, Lawyer should not be liable. This point marks the legal obligation of disclosure for an attorney who chooses to

301. Stevens & Thomas, *supra* note 64, at A1.
302. *See* discussion *supra* part II.B.2(a)(i).
303. *See* discussion *supra* part II.B.2(a)(ii).
304. *See supra* text accompanying note 50.
305. *See* discussion *supra* part II.B.2(a)(iii).
306. *See supra* text accompanying note 111.
307. *See supra* text accompanying note 109; *See also* JENNINGS, *supra* note 104, at 879-80.
308. *See* discussion *supra* parts II.B.2., II.C.2.
309. *See* discussion *supra* part II.B.2(a)(iv).

make representations to the regulatory agency and thereby subjects himself or herself to the disclosure obligations of the financial institution.

In contrast to the attorney making representations directly to a regulatory agency, when an attorney merely acts in the capacity of adviser and watchdog, his or her duty to disclose is lower because the attorney has not subjected himself or herself to the standard of disclosure applicable to financial institutions. Consequently, standards of disclosure applicable in civil proceedings are applicable to an attorney when it is the client who makes representations to the regulatory agency. However, the financial institution's duty to disclose is not lessened,[310] and the attorney cannot employ adversarial tactics to obstruct the examination process. Rather, an attorney who acts in the capacity of adviser and watchdog has no duty to reveal facts adverse to the client institution. This is true even when the client lies and the attorney remains silent, knowing that the statement is a lie.[311] When the Lawyer discovers that S&L has perpetrated a crime or fraud, the ethical rules applicable in adversarial proceedings should also be applicable. Consequently, Lawyer should have a duty to remonstrate with S&L, and if that proves unsuccessful, Lawyer may have a further duty to withdraw or make disclosure to the regulatory agency.[312]

The final questions raised by the hypotheticals are to what degree the scope of employment affects the lawyer's duty to disclose and whether it make a difference if the lawyer has made representations to the regulatory agency.[313] If the lawyer has made representations to the regulatory agency, the answer is straightforward. In that scenario, the lawyer has subjected himself or herself to the disclosure obligations of the financial institution and therefore cannot contract out of the duty to disclose.[314] Indeed, this is the lesson to be learned from Kaye, Scholer in the examination of Lincoln. However, if the lawyer acts in the capacity of adviser and watchdog, the answer becomes more difficult. The ethical rules forbid a lawyer to counsel or assist a client in commit-

310. *See supra* text accompanying note 285.

311. *See* discussion *supra* part II.B.2(b).

312. MODEL RULES OF PROFESSIONAL RESPONSIBLITY Rule 1.13 (1993).

313. *See* discussion *supra* part II.B.2(c).

314. *See* discussion *supra* part II.C.

ting a crime or fraud.[315] Consequently, if a lawyer becomes aware the client is committing a crime or fraud, the lawyer has a duty to remonstrate with the client.[316] If that remonstration proves ineffective, the lawyer may have a further duty to resign or even to disclose.[317] Applying these general guidelines to the last hypothetical example, Lawyer's obligations would turn on whether Lawyer "assisted" S&L in committing a crime or fraud. Whether Lawyer's scope of employment effectively insulates Lawyer from S&L's material omission is beyond the scope of this comment, but if it does, the ethical rules suggest that Lawyer would have no duty to confront S&L, withdraw, or disclose.[318] But if Lawyer's continued employment with S&L will assist S&L in violating its disclosure obligation, then Lawyer would have a duty to remonstrate with S&L, and if that proved ineffective, Lawyer may have a further duty to withdraw or disclose.

IV. PROPOSAL

Any legislation aimed at defining the responsibilities and liabilities of the attorney in a regulatory examination should consider all factors relevant to such a determination.[319] However, the nature of the proceeding is the most important factor that can affect the attorney's duty to disclose.[320] Consequently, given this comment's analysis, the following recommendations should be among those considered if such legislation is drafted. These recommendations can also be used by practitioners seeking to define their role in the regulatory examination of financial institutions:

1. Zealous advocacy, in the traditional sense of advancing a client's position by revealing only the facts most favorable to the client, has no place in an examination.

2. The proper role of an attorney during an examination is to advise the client through the regulatory process and

315. MODEL RULES OF PROFESSIONAL RESPONSIBILITY Rule 3.4 (1993).

316. *Id.* at 1.13(b)(1).

317. *Id.* at 1.13(b)(c).

318. "[A] lawyer may reveal such information to the extent the lawyer reasonably believes necessary: (1) to prevent the client from committing a criminal act that the lawyer believes is likely to result in imminent death or substantial bodily harm." MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.6(b)(1) (1990). This is an unlikely result from the violation of a banking regulation.

319. For a list of relevant factors, see *supra* note 24.

320. *See supra* note 25 and accompanying text.

to monitor the process to guard against possible abuses by the regulatory agency.

3. Upon engagement, counsel should make clear to the client the lawyer's proper role in an examination. A lawyer should stress to the client that an examination is not a trial and that the client cannot avoid disclosure obligations.

4. During the examination, a lawyer should be careful about any representations made to the regulatory agency. If an attorney chooses to represent facts to the regulatory agency on the client's behalf, he or she should be subjected to the same materiality standards as the financial institution itself. A lawyer who makes such representations, yet makes a material omission or misstatement, can escape liability only by making a due diligence inquiry.

5. If a lawyer makes no representations to the regulatory agency, his or her duty to disclose should be similar to that of an attorney in a civil proceeding. Thus, a lawyer serving as adviser and watchdog should have no duty to disclose facts adverse to the client unless the lawyer's representation will assist the client to commit a crime or fraud, in which case the lawyer has a duty to remonstrate with the client, and may have a further duty to withdraw or make disclosures to the regulatory agency.

6. Where counsel chooses to make representations to the regulatory agency and has been limited by the scope of employment, counsel should make clear to the regulatory agency the exact contours of the employment agreement in each and every representation. Such a disclaimer should limit an attorney's liability to that agreed upon in the engagement contract and prevent the regulatory agency from viewing the lawyer as "standing in the shoes" of the client for regulatory purposes.

V. CONCLUSION

The recommendations proposed by this comment are helpful to understand a lawyer's duties in an OTS examination. When creating rules to fit the need of the hour, legislatures and courts frequently look to policy and precedent. This comment suggests that the nature of the proceeding is a

useful tool in determining the proper limits of an attorney's responsibility and liability in all kinds of legal proceedings.

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